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Supreme Court, U.S.
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OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

FRANK L. ALMETER, *et al.*,

Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF THE CITY OF RICHMOND

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

This case is the third to reach this Court alleging the State of Virginia's income tax system discriminates against Federal retirees on their pension income. This Court granted the petitions in the first two cases. In *Harper et al. v. Virginia Dep't. of Revenue*, 501 U.S. 1247 (1991) (*Harper I*), this Court vacated and remanded the Virginia Supreme Court decision. In *Harper et al. v. Virginia Dep't. of Revenue*, 509 U.S. 86 (1993) (*Harper II*) this Court vacated, reversed and remanded the Virginia Supreme Court decision.

This Court's 1989 decision in *Davis v. Michigan Dep't. of Treasury*, 489 U.S. 803 (1989) held a State tax system which discriminates against Federal retirees in favor of retired State employees violates the constitutional doctrine of intergovernmental tax immunity based on the Supremacy Clause. Such a system also violates 4 U.S.C. § 111, which contains Congress' consent to State taxation of the income of Federal officers and employees if the State "taxation does not discriminate against the officer or employee." *Davis* held that preferential state tax treatment of State and local employees pensions is constitutionally invalid for the future and the past. Removing past and future discrimination, however, was likely to cost the States money. Some States, led by Virginia, have resisted the cost of complying with *Davis*. In the first chapter of State resistance, spearheaded by Virginia's *Harper* litigation, the State refused refunds to the Federal retirees claiming that *Davis* did not apply retroactively. *Harper I* (1991). This Court, in a series of decisions ending with the 1993 *Harper II* decision, held that *Davis* applied retroactively and that Virginia must provide a tax refund to the Federal retirees or other meaningful backward looking relief removing the discrimination, *e.g.*, retroactively raising the tax on State retirees if the State preferred that option.

This case involves the second chapter of State resistance — the effort to maintain future discrimination against Federal retirees — which is also led by Virginia. This Court, in *Davis*, held that the States had two options to comply with the mandate of equal treatment to establish a nondiscriminatory system. The States could either: (1) extend the tax exemption to Federal retirees or (2) eliminate the exemption for State retirees. The discrimination could be removed either way, but Virginia took a third option not authorized by this Court. It eliminated the statutory exemption for State retirees but, in connection therewith, increased pension benefits in an amount to offset the new State tax liability. Petitioners alleged below that those increased pension benefits constituted tax rebates to the State retirees. The Virginia option was cost-free to the State since the increased benefits were soon returned to the State Treasury as taxes. Since Federal retirees did not receive any tax rebates, their situation was exactly what it had been before *Davis*. The Virginia Court below upheld the Tax Rebate System finding that *Davis* "specifically contemplated and condoned" the back-door Tax Rebate scheme. The Virginia holding conflicts with the decisions of two other State courts of last resort, Oregon and Montana. The Montana Court found a similar Tax Rebate System "an attempt to evade the requirements of federal law." *Sheehy v. Public Employees Retirement Div.*, 864 P.2d 762 (Mont. 1993). The Virginia decision raises a substantial constitutional and statutory question that should be resolved by this Court.

1. Whether it is constitutionally valid under *Davis* for Virginia to discriminate against Federal retirees by imposing a heavier tax burden on Federal retirement benefits than on State and local retirement benefits through tax rebates to State and local retirees.

PARTIES TO THE PROCEEDING

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The Virginia Department of Taxation; Respondent.

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The Petitioners, Frank L. Almeter *et al.*, respectfully pray that a writ of certiorari issue to review the April 20, 2001 judgment of the Supreme Court of Virginia in the above captioned proceeding.

OPINIONS BELOW

The opinion and judgment of the Circuit Court of the City of Richmond, Judge Randall G. Johnson presiding, of November 6, 2000, is not reported and is reprinted in the Appendix, App. A, *infra*.

The Supreme Court of Virginia judgment, dated April 20, 2001, rejecting the petition for appeal from the judgment and opinion of the Circuit Court of the City of Richmond is not reported and is reprinted in the Appendix hereto, App. B, *infra*.

STATEMENT OF JURISDICTION

The judgment of the Supreme Court of Virginia (App. A) was entered on April 20, 2001. The jurisdiction of this Court to review cases from state courts rests upon 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The U.S. Constitution provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in

> every State shall be bound thereby; any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. Const. art. VI, cl. 2.

The Supremacy Clause, as applied in *Davis v. Michigan Dep't. of Treasury*, 489 U.S. 803 (1989) prohibits a State tax system which discriminates in favor of retired state employees and against retired federal employees as a violation of the doctrine of intergovernmental tax immunity. Supremacy Clause art. VI, cl. 2.

Title 4, section 111 of the United States Code provides:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

The relevant Virginia statutes of 1989, 1990, 1993, 1994, 1998 and 1999, as amended, are set forth in the Appendix. App. C. In summary, Virginia repealed its statutory exemption for State retirees in 1989, Acts 1989, Spec. Sess. II, c. 3, but, in connection therewith, increased pension benefits to offset the new tax. Acts 1990, chs. 507 and 525. The 1990 law requires the Virginia Retirement System to pay its present and future retirees "*an additional permanent retirement benefit whose cost is equivalent to the amount of*

net additional income tax revenues paid by such retirees . . . as a result of the enactment of this act as estimated by the Department of Taxation." *Id.* Petitioners allege that the State, pursuant to this provision, paid a lump sum of $15.75 million in 1993 to cover State taxes paid by State retirees in 1990, 1991, and the first six months of 1992. Petitioners further allege that for the last six months of 1992, 1993 and the first nine months of 1994, the increased pension benefit took the form of a new health care benefit. Acts 1992, chs. 671 and 770. Petitioners also allege that in 1994, to settle litigation brought by State retirees, the "additional retirement allowance" was set at 3% of the retiree's normal pension benefit. Acts 1994, Spec. Sess. I, c. 5. The 3% benefit was in effect as of October 1994, and for 1995, 1996, 1997, and 1998. In 1998 and 1999, the additional allowance was permanently built into the general retirement formula which was increased from 1.65 to 1.70 percent multiplied by years of service. Acts 1998, c. 674 and Acts 1999, c. 111.

STATEMENT OF THE CASE

This is an action brought by 76 retired federal employees, "both individually and as representatives of all others similarly situated," against the Virginia Department of Taxation (Department). Plaintiffs allege that the Virginia Tax Rebate System discriminates against retired Federal employees in favor of retired State employees violating both the constitutional doctrine of intergovenmental tax immunity and 4 U.S.C. § 111 providing Federal consent if a State tax system "does not discriminate" against Federal officers and employees because of the source of the pay. The Complaint further alleges that Virginia — after subjecting its retirees to tax — "in an effort to compensate then current and future State retirees for their increased tax liability, the General

Assembly rebated approximately $15.75 million in a one-time, lump sum payment to State retirees and increased the retirement benefits paid to State retirees by three percent (3%) (together, the "Tax Rebate")." Complaint at ¶ 8. The Plaintiffs requested tax refunds and an injunction against the further collection of the unequal taxes.

The Department moved a plea to the jurisdiction of the court, a plea of sovereign immunity, a plea of the statute of limitations, and demurrer. The trial court found the State's plea to the jurisdiction of the court "not worthy of further comment" but ruled in the State's favor on its demurrer. The trial court, for purposes of the demurrer, accepted as true the plaintiffs allegations that the $15.75 million lump sum payment and the 3% benefit increase was an effort "to compensate then current and future State retirees for their increased tax liability." Circuit Court Letter Opinion at 3. The trial court held, however, that the Tax Rebate System did not give plaintiffs a right to sue. The trial court found that in *Davis*, "both the majority and minority opinions recognized that a State's response" might be a Tax Rebate System, "that is, to pay extra money to state retirees to make up for what those retirees lost as a result of being taxed. Neither opinion condemned that response." *Id.* The trial court concluded that "Because the actions complained about by plaintiffs, even if true, are the types of actions specifically contemplated and condoned by the Supreme Court of the United States in *Davis*, plaintiffs have failed to state a cause of action. The demurrer must be sustained." *Id.* at 5. The Virginia Supreme Court refused the petition for appeal from the trial court on April 20, 2001.

Virginia, for many years prior to 1989, exempted from State taxation retirement benefits paid by the State to state

and local government employees. The retirement benefits of Federal employees, however, were taxed by the State. This Court in *Davis* held that if a State taxes State and local government retirees differently than it taxes federal retirees, the state violates the constitutional doctrine of intergovernmental tax immunity as well as federal statutory law, 4 U.S.C. § 111, consenting to state taxation of federal employees "if the taxation does not discriminate." The Michigan exemption for state and local employees, made a different provision than those applicable to federal employees, and violated both the Constitution and the statute. Therefore, the Court struck down the exemption.

Following *Davis*, Federal retirees in Virginia sought refunds for tax years 1985-88 in accord with the *Davis* mandate of equal treatment. The Virginia Supreme Court, however, rejected the claim. It affirmed the trial court's ruling that *Davis* did not apply retroactively. *Harper et al. v. Dep't. of Taxation*, 401 S.E.2d 868 (Va. 1991) (*Harper I*). The Virginia Supreme Court found the "equities weigh heavily in favor of the Commonwealth" in view of affidavits of Commonwealth officials that payment of the refunds would have a potentially "destructive impact . . . [on the] delivery of essential state services." *Id.* at 873. This Court granted the Federal retirees' petition for certiorari, vacated the judgment and remanded the case "for further consideration in light of *James B. Beam Distilling Co. v. Georgia*," 501 U.S. 1247 (1991) (*Harper I*).

On remand, the Virginia Supreme Court again found that *Davis* did not apply retroactively. *Harper et al. v. Virginia Dep't. of Rev.*, 410 S.E.2d 629 (1991) (*Harper II*). The Virginia Supreme Court held that "nothing articulated in *Beam* requires a result different from that reached in our

prior decision." *Id.* at 632. The Federal retirees' petition for certiorari was again granted by this Court which vacated, reversed and again remanded the case to the Virginia Supreme Court. *Harper II*, 509 U.S. 86 (1993). This Court's opinion recited that *Davis* had held a "State violates the constitutional doctrine of intergovernmental tax immunity" when it taxes retirement benefits paid by the Federal government but exempts from taxation retirement benefits paid by the State. The Supreme Court of Virginia, this Court noted, had "twice refused to apply *Davis* to taxes imposed before *Davis* was decided." *Id.* at 89-90. This Court continued:

> [W]e hold that this Court's application of a rule of federal law to the parties before the Court requires every court to give retroactive effect to that decision. We therefore reverse.

Id. at 90. This Court further noted that in *Davis*: "We held that the United States had not consented under 4 U.S.C. § 111 to this discriminatory imposition of a heavier tax burden on federal benefits than on state and local benefits." *Id.* at 90, citing to *Davis*, 489 U.S. at 808-817.

The Virginia Supreme Court had found "the retroactivity issue was not decided in *Davis*." *Id.* at 98. This Court, however, disagreed:

> We disagree. *Davis* did not hold that preferential state tax treatment of state and local employee pensions, though constitutionally invalid in the future, should be upheld as to all events predating the announcement of *Davis*.

Id. at 98. This Court did not, however, enter judgment for the petitioners "because federal law does not necessarily

entitle them to a refund." *Id.* at 100. Rather, the Constitution requires Virginia to provide relief consistent with federal due process principles. A State "found to have imposed an impermissibly discriminatory tax retains flexibility in responding to this determination" as previously outlined in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 499 U.S. 18, 39-40 (1990). *Id.* Virginia could satisfy due process if it offered taxpayers a predeprivation remedy — *i.e.*, a meaningful opportunity for taxpayers to withhold contested tax assessments and challenge their validity in a predeprivation remedy. *Id.* at 101. If no such predeprivation remedy exists "the Due Process Clause of the Fourteenth Amendment obligates the State to provide meaningful backward — looking relief to rectify any unconstitutional deprivation." *Id.* quoting *McKesson*. A State "may either award full refunds to those burdened by a unlawful tax or issue some other order" that creates in hindsight a nondiscriminatory scheme. *Id.* This Court found "Virginia is free to choose which form of relief it will provide so long as that relief satisfies the minimum federal requirements we have outlined." *Id.* at 102.

The Virginia trial court, on remand, held, for the third time, that the Federal retirees were not entitled to refunds. The trial court found the Federal retirees should have used a declaratory judgment procedure which, the trial court believed, constituted a predeprivation remedy complying with *McKesson* and *Harper II*. The Virginia Supreme Court, in its third decision, finally brought the first chapter of State resistance to *Davis* to a close. It awarded an appeal, reversed the trial court and entered final judgment in favor of the Harper taxpayers directing that the amounts unlawfully collected from them be refunded, with interest. *Harper v. Virginia Dep't. of Taxation*, 462 S.E.2d 892 (1995) (*Harper III*).

The second chapter of State resistance to *Davis* is now presented to this Court. In *Davis*, this Court advised the States that Federal and State retirees had to be treated equally. There was a "mandate of equal treatment." 489 U.S. at 818. Future discrimination against Federal retirees could be ended by either exempting both Federal and State retirees or by taxing both groups. This Court found:

> In this case, appellant's claim could be resolved either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees.

489 U.S. at 818. Virginia rejected both approved options. The first option, extending the exemption to Federal retirees, would cost the State many millions annually in lost future State tax revenues. The second option, simply repealing the exemption enjoyed by State retirees, would cut the take-home benefits for current and future retirees. It would be unpopular and very likely lead to lawsuits challenging the State's right to remove the exemption from vested members.

Virginia created for itself a third option; it repealed the exemption for State retirement income but, in connection therewith, increased benefits to State retirees by an amount intended to cover the retiree's new tax liability. The State retiree, because of the increased pension, in substance, continued to enjoy his tax exemption. The Federal retirees continued to pay tax as they had before *Davis*. The Virginia third option is, of course, cost free to the State — Federal retirees continue to pay taxes while the new benefits paid to State retirees are regularly returned to the State as new taxes. The State effectively retained the old discriminatory pattern held unconstitutional in *Davis* at no cost to itself.

REASONS FOR GRANTING THE WRIT

The writ should be granted because the Virginia Supreme Court has decided an important constitutional and statutory question in a way that conflicts with the decision of this Court in *Davis* and the decisions of the Oregon Supreme Court and the Montana Supreme Court (Sup. Ct. R. 10(b) and (c)). The Virginia Supreme Court decision of April 20, 2001 (Holding that Virginia tax rebates paid to State retirees but not to Federal retirees do not discriminate against Federal retirees) conflicts with this Court's decision in *Davis* and the decisions of the Supreme Courts of Oregon, *Vogl v. Dep't. of Revenue*, 327 Or. 193, 960 P.2d 373 (1998) and Montana, *Sheehy v. Public Employers Div.*, 262 Mont. 129, 864 P.2d 762 (1993) (Both holding that State tax rebates paid to State retirees but not to Federal retirees discriminate against Federal retirees).

It should not be arguable that the *Davis* mandate of equal treatment is violated when the State puts a heavier tax burden on Federal retirees than on State retirees. In *Sheehy*, the Montana Supreme Court found the State violated section 111 when it awarded an "annual retirement adjustment payment" to State retirees at the same time it repealed its tax exemption for state retirement income. *Sheehy v. Public Employees Retirement Division*, 864 P.2d 762 (Mont. 1993). The court found the new adjustment was "intended to make up, in part," for the new tax liability placed on State retirees. *Id.* at 768. Therefore, "the adjustment is not an actual and legitimate pension or retirement benefit." *Id.* Instead, it "is a partial tax rebate denominated otherwise in an attempt to evade the requirements of federal law." *Id.*[1]

1. This Court, in the context of the dormant Commerce Clause, struck down a facially even-handed state tax because Massachusetts, (Cont'd)

Oregon, in 1995 — after a decision holding that the State had breached its contractual obligation to State retirees by repealing their statutory exemption — enacted a new pension increase "to compensate for damages suffered by members of [the State Retirement System . . . by reason of subjecting benefits . . . to Oregon personal income taxation." *Vogl v. Dep't. of Revenue*, 960 P.2d 373, 380 (Or. 1998). The Oregon Supreme Court concluded that "the benefit increase provided therein is, in substance, a tax rebate." *Id.* at 381. The new benefit "substantially eliminates the tax on PERS benefits, without extending the same favorable tax treatment to federal retirement benefits." *Id.* at 382. The federal retirees were held entitled to a refund of State income tax paid on their federal retirement income.

Three years after *Davis*, this Court unanimously struck down a Kansas system that taxed the benefits received from the United States by military retirees but did not tax the benefits received by retired state and local government employees. *Barker v. Kansas*, 503 U.S. 594 (1992). This Court found its "approach to deciding this case is controlled by *Davis*." *Id.* at 597. This Court noted that in *Davis* it had traced the history of 4 U.S.C. § 111 and concluded that "retention of immunity in § 111 is coextensive with the prohibition against discriminatory taxes embodied in the

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(Cont'd)
by "conjoining a tax and a subsidy," effectively granted tax rebates to in-state dairy farmers. *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 (1994). This Court noted that its Commerce Clause jurisprudence is not controlled by "the form by which a State erects barriers to commerce; . . . [the Clause] forbids discrimination, whether forthright or ingenious." at 201. The issue in each case is whether the statute, "whatever its name may be, will in practical operation work discrimination against interstate commerce." *Id.*

modern constitutional doctrine of intergovernmental tax immunity." *Id.* at 598, quoting *Davis*, 489 U.S. at 813. Under that doctrine, this Court evaluates a state tax alleged to discriminate against Federal employees in favor of state employees by inquiring whether the inconsistent tax treatment is directly related to, and justified by, significant differences between the two classes. *Id.* This Court rejected the State's efforts to create significant differences, finding persuasive the Brief for the United States as *Amicus Curiae* which argued that the "State's articulated rationale is not, in fact, the basis for the disparate treatment, but only a cloak for discrimination against federally funded benefits." *Id.* at 604-05.

Justice Stevens, the lone dissenter in *Davis*, wrote a concurring opinion in *Barker*. Justice Stevens agreed the decision was controlled by *Davis* but repeated — in order to call it to the attention of Congress — his argument that *Davis* "seriously misapplied the doctrine of intergovernmental tax immunity." *Id.* at 606. Justice Stevens repeated his argument, rejected in *Davis*, that a state tax exempting state retirees does not discriminate against Federal retirees if the tax is also paid by the "vast majority of the State's citizens." *Id.* Federal judges, according to Justice Stevens, "should not be able to claim an exemption simply because a State decides to give such a benefit to members of the judiciary instead of raising their salaries." *Id.* The majority in *Davis* had rejected Justice Stevens' its-just-like-a-payment critique pointing out in Footnote 4 that at least one difference is that if the State paid higher wages the increased payments "in some circumstances," would result in "higher federal income tax payments." 489 U.S. at 815. There would, of course, be no higher federal income tax payments if the State retiree itemized his deductions.

In any case, Justice Stevens position was considered and rejected in *Davis* as he himself recognized in *Barker*. The Virginia trial court's opinion in this case is apparently based on its misunderstanding of Justice Stevens' dissent and the majority's response in Footnote 4.[2] The Virginia trial court believes Justice Stevens' its-just-like-a-payment critique is the law of *Davis*, not a rejected argument.

More fundamentally, the Virginia trial court analysis fails to recognize that the modern doctrine of intergovernmental tax immunity focuses upon the effect discriminatory state taxing practices have upon Federal employees — not their effect upon the Federal government. Congress has recognized this in 4 U.S.C. § 111, which makes no reference to discrimination against the Federal government — only employees thereof. With respect to Federal retirees, this Court has given effect to the doctrine, through 4 U.S.C. § 111, in *Davis*. Virginia, in order to escape the force and effect of the statute and this Court's precedents, attempts to re-cast the analysis as one which considers only the impact its taxing practices have upon the Federal government. As it

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2. The unstated corollary to the hypothetical posited in Justice Stevens' dissent and addressed by the majority in Footnote 4 of *Davis* is that, the State, by denying Federal retirees an exemption from state income taxation equivalent to that available to state retirees, the result is that Federal income tax payments by Federal retirees are lower than they otherwise would be. This is so because exemption of Federal retirement benefits from state income taxation reduces the state and local tax deduction available to Federal retirees. Therefore, even assuming that the proper analysis with respect to the doctrine of intergovernmental tax immunity focuses upon the effect a state taxing practice has on the Federal government (an assumption Petitioner's address, *infra*), it is far from clear that the result arising from Justice Stevens' hypothetical is beneficial to the Federal government.

did in *Harper I* and *Harper II*, this Court should reject Virginia's efforts to elude compliance with the mandates of the intergovernmental tax immunity doctrine.

CONCLUSION

This Court should resolve whether Virginia's Tax Rebate System is "specifically contemplated and condoned," by *Davis* as the Virginia Supreme Court believes, or whether it is a violation of *Davis* and an "attempt to evade the requirements of federal law" as the Montana Supreme Court found. The Virginia Supreme Court misunderstands the Supremacy Clause. Virginia has discriminated against Federal retirees over the past 10 years both retroactively and prospectively. This Court vacated Virginia Supreme Court decisions in 1991 and 1993 to prevent retroactive discrimination. This case requests this Court to prevent prospective discrimination. The Virginia Supreme Court treats *Davis* as a case which does not address a matter of constitutional principle, but as a case sanctioning a rule of form which States can easily evade at no cost by recasting their discrimination by replacing a tax exemption with a tax rebate — notwithstanding that the result is to continue placing a heavier tax burden on Federal retirees. The Virginia Supreme Court both trivializes *Davis* and conflicts with *Davis* and the decisions of two other state courts of last resort.[3]

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3. The United States as *Amicus Curiae* in support of the *Barker* taxpayers noted review by this Court is particularly significant in a constitutional challenge to a state tax system because the lower federal courts are foreclosed in these cases:

> the need for review by this Court is particularly significant in a case involving a constitutional challenge to a state

(Cont'd)

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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(Cont'd)

> tax system, because the Eleventh Amendment, the Tax Injunction Act, 28 U.S.C. 1341, and prudential decisions of this Court, see, *e.g.*, *Fair Assessment in Real Estate Ass'n, Inc. v. McNary*, 454 U.S. 100, 116 (1981), foreclose the lower federal courts as tribunals in these cases. *This Court is the only federal tribunal with the capacity to address the issues presented by this case.*

Brief for the United States as *Amicus Curiae* at 13-14 (emphasis added).

APPENDIX

APPENDIX A — LETTER OPINION AND ORDER OF THE CIRCUIT COURT OF THE CITY OF RICHMOND DATED AND ENTERED NOVEMBER 6, 2000

Circuit Court
of the
City of Richmond

John Marshall Courts Building

400 North Ninth St.
Richmond, Virginia 23219-1999

Randall G. Johnson
Judge

November 6, 2000

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Re: Case No. LL-821-4
Frank Almeter, et al.
v.
Virginia Department of Taxation

Appendix A

Dear Counsel:

This is an action brought by 76 retired federal employees, "both individually and as representatives of all others similarly situated," against the Virginia Department of Taxation (Department). Plaintiffs seek a refund of state income taxes "illegally and unconstitutionally collected from them;" a declaration that a 3% "Tax Rebate" formerly contained in Va. Code § 15.1-155 violates the federal and state constitutions; and an injunction prohibiting the Commonwealth from "further collection found equal taxes from the Federal Retirees," "allocating, disbursing, dissipating, or otherwise spending the funds illegally collected from Federal Retirees," and "commingling the funds illegally collected from the Federal Retirees with other tax revenues collected by the Commonwealth." Plaintiffs also seek attorney's fees, costs, and interest on any refunds awarded. The case is before the court on the Department's "plea to the jurisdiction of the court," plea of sovereign immunity, plea of the statute of limitations, and demurrer. Because the court concludes that plaintiff's have not stated a cause of action, only the demurrer needs to be considered. Before doing so, some background is needed.[1]

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1. The court recognizes, of course, that if the Department's challenge to the court's jurisdiction has merit, the court cannot address the demurrer. The court holds, however, that the Department's challenge to the court's jurisdiction is without merit and is, in fact, not worthy of further comment, except to note that what the Department really challenges is the relief which plaintiffs seek in this action, not the fact that an action challenging a tax assessment can be brought.

(Cont'd)

Appendix A

In *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), the Supreme Court of the United States held that a state may not exempt from income taxation retirement benefits paid to state retirees unless such exemption is also granted to federal retirees. Although the case specifically involved the tax laws of Michigan, it had the effect of invalidating similar laws in several other states, including Virginia. Accordingly, in 1989, Virginia's General Assembly repealed the exemption that had been granted to state retirees, Acts of Assembly 1989, Spec. Sess. II, c.3, and in 1994 enacted the Federal Retirees Settlement Program, which authorized the Tax Commissioner "to make settlement payments to taxpayers to resolve disputed claims for refunds of taxes paid with respect to retirement or pension benefits received from a federal retirement system . . . for any taxable year beginning on or after January 1, 1985, and ending on or before December 31, 1988." Acts of Assembly 1994, Spec. Sess. I, c.5. The 1994 legislation also provided that affected taxpayers "shall be given the option of whether they want to participate in the settlement" and that those who did not want to participate "will have the option of having their entitlement to refunds determined by existing litigation or filing suit themselves. *Id.*, p.13. Finally in *Harper v. Virginia Dept. of Taxation*, 250 Va. 184, 462 S.E.2d 892 (1995), the Supreme Court of Virginia held that Va. Code § 58.1-1826 required the state to pay refunds to federal retirees in a number of

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(Cont'd)

The court also will not address the propriety of plaintiffs' bringing this action "as representatives of all others similarly situated." Class actions are not generally allowed in Virginia. In light of the court's ruling on the demurrer, however, that issue need not be considered.

consolidated actions who had brought suit in *Davis*' wake. With this background in mind, the court will now turn to the case before it.

The present plaintiffs contend that the General Assembly did two things in response to the decision that violated 4 U.S.C. § 111, which is the federal law that prohibits the "state-retirees-only" exemptions invalidated in *Davis*. First, plaintiffs claim that the General Assembly rebated approximately $15.75 million in a one-time, lump-sum payment to state retirees. Second, plaintiffs claim that the General Assembly increased the retirement benefits paid to state retirees by 3%. Both of those actions, say plaintiffs, were a direct attempt to give state retirees the same benefits they had before *Davis*, and, thus, avoid *Davis*' holding. In fact, Va. Code § 51.1-155 was amended in 1994 to add an additional retirement allowance of 3% for state employees who retired between October 1, 1994, and December 31, 1998. That provision was deleted in 1999. The court has not researched whether the lump-sum payment of $15.75 million was also appropriated in 1994 or at any other time but will, for purposes of demurrer, take plaintiff's allegation in that regard to be true. *Catercorp, Inc. v. Catering Concepts, Inc.*, 246 Va. 22, 24, 431 S.E.2d 277 (1993). The fact is that neither of those events gives plaintiffs a right to sue.

In *Davis*, both the majority and minority opinions recognized that a state's response to the Court's holding might be exactly what plaintiffs now claim was the response of Virginia's General Assembly; that is, to pay extra money to state retirees to make up for what those retirees lost as a result of being taxed. Neither opinion condemned that response. In his dissenting opinion, Justice Stevens said:

> Even if it were appropriate to determine the discriminatory nature of a tax system by comparing the treatment of federal employees with the treatment of another discrete group of persons, it is peculiarly inappropriate to focus solely on the treatment of state governmental employees. *The State may always compensate in pay or salary for what it assesses is taxes.* Thus a special tax imposed only on federal and state employees nonetheless may reflect the type of disparate treatment that the intergovernmental tax immunity forbids because of the ability of the State to adjust the compensation of its employees to avoid any special tax burden on them. . . . It trivializes the Supremacy Clause to interpret it as prohibiting the States from providing through this limited tax exemption *what the State has an unquestionable right to provide through increased retirement benefits.*

489 U.S. at 824 (emphasis added, citation and footnote omitted).

While not agreeing with the first sentence in the above passage, the majority took no issue with a state's ability to lawfully increase the benefits paid to state retirees to offset the effect of the Court's holding:

> We also take issue with the dissent's assertion that "it is peculiarly inappropriate to focus solely on the treatment of state governmental employees" because "[t]he State may always

> compensate in pay or salary for what it assesses in taxes." *Post*, at 824. In order to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefit payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances. This fact serves to illustrate the impact on the Federal Government of the State's discriminatory tax exemption for state retirees. Taxes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.

489 U.S. at 815 n.4.

Because the actions complained about by plaintiffs, even if true, are the types of actions specifically contemplated and condoned by the Supreme Court of the United States in *Davis*, plaintiffs have failed to state a cause of action. The demurrer must be sustained.

A copy of an order is enclosed.

Very truly yours,

s/ Randall G. Johnson
Randall G. Johnson

Appendix A

VIRGINIA

In the Circuit Court of the City of Richmond,
John Marshall Courts Building

LL-821-4

FRANK ALMETER, ET AL.,

Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,

Defendant.

ORDER

This cause came on October 19, 2000, on defendant's please to the jurisdiction of the court, plea of sovereign immunity, plea of the statute of limitations, and demurrer, and was argued by counsel.

Upon consideration whereof, and for the reasons stated in the letter opinion dated this date, it is —

ORDERED that defendant's plea to the jurisdiction of the court is overruled and its demurrer is sustained. The action is dismissed.

Appendix A

The objections of the parties to the portions of this order adverse to them are noted.

A copy of this order was mailed this day to counsel of record.

ENTER 11/6/2000

s/ Randall G. Johnson
Randall G. Johnson, Judge

APPENDIX B — ORDER OF THE SUPREME COURT OF VIRGINIA REFUSING PETITION FOR APPEAL DATED APRIL 20, 2001

VIRGINIA

In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on Friday ***the*** 20th ***day of*** April, 2001.

Record No. 010270
Circuit Court No. LL-821-4

Frank Almeter, et al.,

Appellants,

against

Virginia Department of Taxation,

Appellee.

From the Circuit Court of the City of Richmond

Upon review of the record in this case and consideration of the argument submitted in support of and in opposition to the granting of an appeal, the Court is of opinion there is no reversible error in the judgment complained of. Accordingly, the Court refuses the petition for appeal.

A Copy,

Teste:

David B. Beach, Clerk

By: s/
Deputy Clerk

APPENDIX C — RELEVANT STATUTES

ACTS OF ASSEMBLY

Chapter 3

An Act to amend and reenact §§ 51-111.15, 51-112, 51-127.7, 58.1-322 and 58.1-330 as currently in effect and as effective for taxable years beginning on and after January 1, 1990, of the Code of Virginia, to repeal § 51-180 of the Code of Virginia, and to repeal Chapter 749 of the 1989 Acts of Assembly, all relating to the taxation of retirement benefits.

Approved May 22, 1989

Be it enacted by the General Assembly of Virginia:

1. That §§ 51-111.15, 51-112, 51-127.7, 58.1-322 and 58.1-330 as currently in effect and as effective for taxable years beginning on and after January 1, 1990, of the Code of Virginia are amended and reenacted as follows:

§ 51-111.15 Exemption of assets from taxation: exemption of benefits and assets from execution and assignment.~~— Retirement allowance and other benefits accrued or accruing to any person~~ *The assets of the retirement systems created* under the provisions of Chapter 3.2 (§ 51-111.9 et seq.) or Chapter 6 (§ 51-143 et seq.) of ~~this title~~ *Title 51*; ~~and the assets of the retirement systems created under these chapters,~~ are hereby exempted from any state, county, or municipal tax, ~~and~~. *Retirement allowances and other benefits accrued or accruing to any person under the provisions of Chapter 3.2 (§ 51-111.9 et seq.) or Chapter 6*

Appendix C

(§ 51-143 et seq.) of Title 51 and the assets of the retirement systems created under these chapters shall not be subject to execution, attachment, garnishment or any other process whatsoever, except any process for a debt to any agency which has employed such person, nor shall any assignment thereof be enforceable in any court.

ACTS OF ASSEMBLY

Chapter 507

An Act to amend and reenact § 58.1-322 of the Code of Virginia and to repeal § 58.1-330 of the Code of Virginia, relating to the Virginia individual income tax and state retirement benefits.

Approved April 4, 1990

Be it enacted by the General Assembly of Virginia:

* * *

3. That the Virginia Supplemental Retirement System shall provide to its present and future retirees, or their survivors, an additional permanent retirement benefit whose cost is equivalent to the amount of net additional income tax revenues paid by such retirees or their survivors in taxable year 1990, as a result of the enactment of this act, as estimated by the Department of Taxation.

4. That the provisions of this act shall become effective for taxable years beginning on and after January 1, 1990.

Appendix C

ACTS OF ASSEMBLY

Chapter 525

An Act to amend and reenact § 58.1-322 of the Code of Virginia and to repeal § 58.1-330 of the Code of Virginia, relating to the Virginia individual income tax and state retirement benefits.

Approved April 4, 1990

Be it enacted by the General Assembly of Virginia:

* * *

3. That the Virginia Supplemental Retirement System shall provide to its present and future retirees, or their survivors, an additional permanent retirement benefit whose cost is equivalent to the amount of net additional income tax revenues paid by such retirees or their survivors in taxable year 1990, as a result of the enactment of this Act, as estimated by the Department of Taxation.

4. That the provisions of this act shall become effective for taxable years beginning on and after January 1, 1990.

Appendix C

ACTS OF ASSEMBLY

Chapter 671

An Act to amend and reenact the third enactments of Chapters 507 and 525 of the 1990 Acts of Assembly, relating to state retirement benefits.

Approved April 3, 1992

Be it enacted by the General Assembly of Virginia:

1. That the third enactment of Chapter 507 of the 1990 Acts of Assembly is amended and reenacted as follows:

3. That the Virginia ~~Supplemental~~ Retirement System shall provide *on July 1, 1993*, to its present and future retirees; ~~or their survivors,~~ an additional ~~permanent retirement~~ *health care credit* benefit ~~whose cost is equivalent to the amount of net additional income tax revenues paid by such retirees or their survivors in taxable year 1990, as a result of the enactment of this act, as estimated by the Department of Taxation~~ *pursuant to §§ 2.1-20.1:2, 2.1-20.1:3 and 2.1-20.1:4.*

2. That the third enactment of Chapter 525 of the 1990 Acts of Assembly is amended and reenacted as follows:

3. That the Virginia ~~Supplemental~~ Retirement System shall provide *on July 1, 1993*, to its present and future retirees; ~~or their survivors,~~ an additional ~~permanent retirement~~ *health care credit* benefit ~~whose cost is equivalent to the amount~~

Appendix C

~~of net additional income tax revenues paid by such retirees or their survivors in taxable year 1990, as a result of the enactment of this act, as estimated by the Department of Taxation~~ *pursuant to §§ 2.1-20.1:2, 2.1-20.1:3 and 2.1-20.1:4.*

ACTS OF ASSEMBLY

Chapter 5

An Act to amend and reenact §§ 51.1-130, 51.1-155, 51.1-157, 51.1-206, 51.1-306, 51.1-38, 58.1-322 and 58.1-1823 of the Code of Virginia; to authorize the Tax Commissioner to enter into settlement agreements with certain taxpayers; and to appropriate funds therefor, all relating to disputes involving taxation of retirement income and related financial issues.

Approved July 13, 1994

Be it enacted by the General Assembly of Virginia:

1. That §§ 51.1-130, 51.1-155, 51.1-157, 51.1-206, 51.1-306, 51.1-308, 58.1-322 and 58.1-1823 of the Code of Virginia are amended and reenacted as follows:

§ 51.1-130. Resolutions of governing body; approval by Board.

A. The governing body of a political subdivision may adopt a resolution requesting that its eligible employees become members of the retirement system. The governing

body's resolution shall be submitted to the Board for approval, and acceptance of the employees in the retirement system shall be at the option of the Board. If the Board approves the resolution eligible employees may become members of the retirement system.

B. The governing body of any political subdivision approved for participation in the retirement system pursuant to subsection A may adopt a resolution that provides, on or after October 1, 1994, an additional retirement allowance not to exceed three percent of the applicable service or disability retirement allowances payable under §§ 51.1-155, 51.1-157, 51.1-206, 51.1-306, or 51.1-38.

§ 51.1-155. Service retirement allowance.

A. Retirement allowance. A member shall receive an annual retirement allowance, payable for life, as follows:

1. Normal retirement. — The allowance shall equal 1.50 percent of the first $13,200 of average final compensation plus 1.65 percent of average final compensation in excess of $13,200, multiplied by the amount of creditable service. If the member is credited with thirty-five or more years of service, he shall receive 1.65 percent of his average final compensation multiplied by the amount of his creditable service.

On and after October 1, 1994, any employee or local officer who is a member or beneficiary of a retirement system administered by the Board shall receive an additional retirement allowance equal to three percent of the service

retirement allowance payable under this section; provided that, for purposes of this additional retirement allowance, the term employee shall include only those employees of political subdivisions that have adopted a resolution providing for such an allowance under § 51.1-130B. Average final compensation attributable to service as Governor, Lieutenant Governor, Attorney General, or member of the General Assembly shall not be included in computing this additional retirement allowance.

ACTS OF ASSEMBLY

Chapter 674

An Act to amend and reenact §§ 51.1-155, 51.1-157, 51.1-206 and 51.1-306 of the Code of Virginia, relating to Virginia's retirement systems; retirement allowance formula.

Approved April 16, 1998

Be it enacted by the General Assembly of Virginia:

1. That §§ 51.1-155, 51.1-157, 51.1-206 and 51.1-306 of the Code of Virginia are amended and reenacted as follows:

§ 51.1-155. Service retirement allowance.

A. Retirement allowance. — A member shall receive an annual retirement allowance, payable for life, as follows:

Appendix C

1. Normal retirement. — The allowance shall equal ~~1.50~~ *1.70* percent of ~~the first $13,200 of~~ *his* average final compensation ~~plus 1.65 percent of average final compensation in excess of $13,200, multiplied by the amount of creditable service. If the member is credited with thirty-five or more years of service, he shall receive 1.65 percent of his average final compensation~~ multiplied by the amount of his creditable service.

~~On and after~~ *For retirements between* October 1, 1994, *and December 31, 1998*, any employee or local officer who is a member or beneficiary of a retirement system administered by the Board shall receive an additional retirement allowance equal to three percent of the service retirement allowance payable under this section; provided that, for purposes of this additional retirement allowance, the term employee shall include only those employees of political subdivisions that have adopted a resolution providing for such an allowance under subsection B of § 51.1-130. Average final compensation attributable to service as Governor, Lieutenant Governor, Attorney General, or member of the General Assembly shall not be included in computing this additional retirement allowance.

ACTS OF ASSEMBLY

Chapter 111

An Act to amend and reenact §§ 51.1-126.5, 51.1-153, 51.1-155, 51.1-162, 51.1-165, 51.1-205, 51.1-207, 51.1-308, and 51.1-505 of the Code of Virginia, relating to the Virginia Retirement System.

Approved March 16, 1999

Appendix C

Be it enacted by the General Assembly of Virginia:

1. That §§ 51.1-126.5, 51.1-153, 51.1-155, 51.1-162, 51.1-165, 51.1-205, 51.1-207, 51.1-308, and 51.1-505 of the Code of Virginia are amended and reenacted as follows:

§ 51.1-155. Service retirement allowance.

A. Retirement allowance. — A member shall receive an annual retirement allowance, payable for life, as follows:

1. Normal retirement. — The allowance shall equal 1.70 percent of his average final compensation multiplied by the amount of his creditable service.

~~For retirements between October 1, 1994, and December 31, 1998, any employee or local officer who is a member or beneficiary of a retirement system administered by the Board shall receive an additional retirement allowance equal to three percent of the service retirement allowance payable under this section; provided that, for purposes of this additional retirement allowance, the term employee shall include only those employees of political subdivisions that have adopted a resolution providing for such an allowance under subsection B of § 51.1-130. Average final compensation attributable to service as Governor, Lieutenant Governor, Attorney General, or member of the General Assembly shall not be included in computing this additional retirement allowance.~~